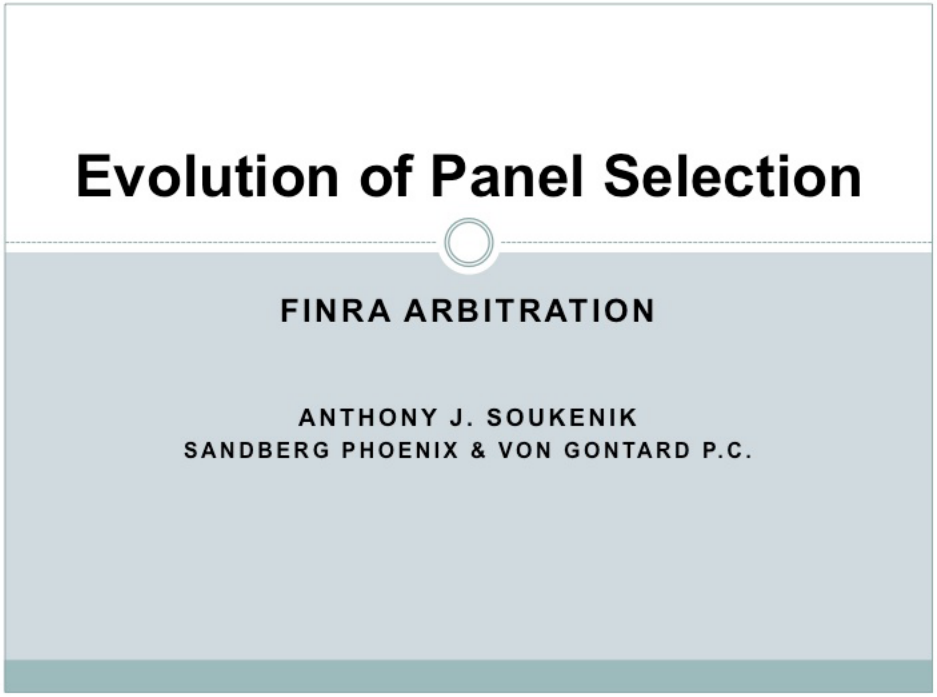
FINRA Arbitration: Evolution of Panel Selection

Anthony Soukenik
Sandberg Phoenix & von Gontard (St. Louis, MO)

asoukenik@sandbergphoenix.com | 314.446.4279
http://www.sandbergphoenix.com/attorneys-anthony-soukenik/



Introduction

- The FINRA Panel Selection Process is once again changing; qualifications for Pubic Panelists is tightening; and the absence of a mandatory industry Panelist (in investor cases) requires compensating adjustments in how parties present their FINRA arbitration cases.

Overview

1. Background on Panel Composition and Selection Process
2. Proposed Changes to Selection Process
   - Proposed Rule SR-FINRA-2013-023 (Rule 12403)
   - Elimination of customer election
   - New uniform method for selection & list composition
   - Breakdown of new strike rules
   - Rule effecting arbitration selection process since 2003
3. Changes to Definition of Public Arbitrator
   - Regulatory Notice 13-21; Effective July 1, 2013
   - Exclusion of persons associated with mutual funds and hedge funds
   - Implementation of the two-year cooling off period
4. Implications on Panel Dynamics and Deliberation from an Insider's Perspective
5. FINRA's Pilot Program for Telephonic Mediation

Background on Panel Composition and Selection Process

- Overview
- Arbitration Selection Process
  - Investor Cases
  - Industry Cases
    - Disputes Between Brokerage Firms
    - Disputes Between Brokers and Between or Among Brokerage Firms and Brokers
- How to Become a Public Arbitrator

Overview

- Arbitration is an alternative to litigation in order to resolve a dispute.
- Arbitration panels are composed of one or three arbitrators who are selected by the parties.
- The panel's decision, called an "award," is final and binding on all the parties.
- Arbitration cases are eligible to be heard in FINRA's forum if the following criteria are met:
  - For disputes with investors:
    - The cases involve an investor and an individual or entity with FINRA.
  - For disputes involving industry parties only:
    - The cases involve an individual or entity registered with FINRA, and
- The claim is filed within 6 years from the time the events giving rise to the dispute occurred.

Arbitration Selection Process

- The number of arbitrators appointed to a case depends on the amount and type of relief requested in the Statement of Claim.
  - For claims of $50,ooo or less, FINRA will appoint one arbitrator.
    - (in person hearing optional)
  - Generally, for claims of more than $50,000 up to $100,000, the parties will select and FINRA will appoint one arbitrator, unless the parties agree in writing to three arbitrators.
  - For claims of more than $100,000, the parties will select and FINRA will appoint three arbitrators.
- FINRA uses the Neutral List Selection System (NLSS) to generate randomly lists of arbitrators from FINRA's arbitrator rosters to appoint a panel.
  - FINRA will send the lists and arbitrator disclosure reports to the parties for review.
  - Parties can strike arbitrators and then will rank the remaining.
- After parties submit their ranked choices, FINRA combines the lists and appoints the highest ranked available arbitrator from each list to be on the panel.

Arbitration Selection Process: Investor Cases

- Cases decided by one arbitrator:
  - Claims of more than $50,000 up to $100,000; arbitrator will be a public arbitrator selected from the public chairperson roster.
  - Strike rules.
- Cases decided by three arbitrators (Rule 12403):
  - Claims of more than $100,000; Parties will select, and FINRA will appoint, three arbitrators.
    - Panel of two public arbitrators and one non-public arbitrator ("Majority-Public Panel"); or
    - Panel of all public arbitrators ("Optional All-Public Panel").
      - Known as the "Composition Rule for All Public Panels".
  - Strike rules.
  - Only investors (whether a claimant or respondent) choose the panel selection method. Neither the Brokerage Firm nor the Broker may choose.
  - "Majority-Public Panel" is the default selection method.
  - Does not apply to cases involving only industry parties.

Arbitration Selection Process: Industry Cases – Disputes Between Brokerage Firms

- Cases decided by one arbitrator:
  - Claims of more than $50,000 up to $100,000; Arbitrator will be a non-public arbitrator selected from the non-public chairperson roster.
  - Strike rules.
- Cases decided by three arbitrators:
  - Claims of more than $100,000; The three arbitrators will be non-public arbitrators.*
    - One selected from the non-public chairperson roster;
    - One selected from list of 20 non-public arbitrators; and
    - One selected from list of 10 chair-qualified non-public arbitrators.
  - Strike rules.
  - *Proposed Rule: Remove requirement for non-public panel member.
    - SR-FINRA-2013-023.

Arbitration Selection Process: Industry Cases – Disputes Between Brokers and Between or Among Brokerage Firms and Brokers

- Cases decided by one arbitrator:
  - Claims of more than $50,000 up to $100,000; Arbitrator will be a public arbitrator selected from public chairperson roster.
  - Strike rules.
- Cases decided by three arbitrators:
  - Claims of more than $100,000.
  - Selected from the following lists*:
    - One from list of 10 chair-qualified public arbitrators;
    - One from list of 10 public arbitrators; and
    - One from list of 10 non-public arbitrators.
  - Strike rules.
  - *Proposed Rule: Remove requirement for non-pubic panel member.
    - SR-FINRA-2013-023.

Becoming a Public Arbitrator

- FINRA has two classifications of arbitrators: Public and Non-Public.
  - Public: select individuals who are not required to have knowledge of the securities industry.
  - Non-Public: have a more extensive securities industry background.
- Unless waived by FINRA, applicants must have a minimum of five years of paid business and/or professional experience – inside or outside of the securities industry – and at least two years of college-level credits.
- Arbitrators must complete FINRA's Basic Arbitrator Training Program:
  - Basic Arbitrator Training (Part I);
  - Expungement Training (Part II); and
  - Live Video OR Onsite Classroom Training Session (Part III).

Proposed Changes to Selection Process

- Proposed Rule SR-FINRA-2013-023
- Elimination of Customer Election
- New Uniform Method for Selection & List Composition
- Breakdown of New Strike Rules
- Rules Effecting Arbitration Selection Since 2003

Proposed Rule SR-FINRA-2013-023

- Proposed rule change to amend FINRA Rule 12403 of the Customer Code to simplify arbitration panel selection in cases with three arbitrators.
- FINRA would no longer require a customer to elect a panel selection method.
- Parties in all customer cases with three arbitrators would get the same selection method.
- FINRA would provide all parties with lists of:
  - 10 chair-qualified public arbitrators;
  - 10 public arbitrators; and
  - 10 non-public arbitrators.
- FINRA would permit parties to strike four arbitrators on the chair-qualified public list and on the public list
- Any party could select an all-public arbitration panel by striking all of the arbitrators on the non-public list

Elimination of Customer Election

- Proposed Rule Language:
  - "Under the proposed rule change, FINRA would no longer require a customer to elect a panel selection method, and parties in all customer cases with three arbitrators would get the same selection method."
- Basis and Purpose of Rule Change:
  - The provisions in the All Public Panel Option would be the panel composition method for the forum.
  - Users benefit for many reasons:
    - Simplify arbitration selection process for parties and FINRA staff;
    - Leaves in place method affirmatively chosen in approximately three-quarters of customer cases;
    - Ensures that every party has an opportunity to see the list of non-public arbitrators and rank or strike arbitrators on the list; and
    - Ensure that customers would not miss opportunity to select an all public panel.

New Uniform Method for Selection & List Composition

- The provisions in the All Public Panel Option as currently codified, with one clarifying change, would be the panel composition method for the forum.
  - The clarifying change relates to striking and ranking arbitrators.
- Lists:
  - A list of 10 arbitrators from the FINRA non-public arbitrator roster;
  - A list of 10 arbitrators from the FINRA public arbitrator roster; and
  - A list of 10 public arbitrators from the FINRA chair-qualified public arbitrators roster.

Breakdown of New Strike Rules

- Proposed Rule Language:
  - "FINRA would permit the parties to strike four arbitrators on the chair-qualified public list and on the public list."
  - "However, any party could select an all-public arbitration panel by striking all of the arbitrators on the non-public list."

Other Rules Effecting Arbitration Selection Process Since 2003

- 2-21- SEC approved amendments to the Definition of Public Arbitrator.
- 12-30 (effective July 23, 2012): Raise limit for simplified arbitration from $25,000 to $50,000.
- 11-22 (effective June 6, 2011): Appointment of chair-qualified public arbitrators in promissory note disputes.
- 11-05 (effective February 1, 2011): Customer option to choose an all-public arbitration panel in all cases.
- SR-FINRA-2010-022: Proposal to increase the number of arbitrators on each list generated by the NLSS.
- 10-37 (effective September 27, 2010): Increase in number of arbitrators available for review when parties choose arbitration panels.
- 09-43 (effective August 31, 2009): Amendments to the panel composition rules of the arbitration code for industry disputes.
- SR-FINRA-2008-047: Proposal to change the amount in controversy heard by a single chair-qualified arbitrator to $100,000.
- SR-FINRA-2004-164: Proposal to change the method used by the NLSS.

Changes to Definition of Public Arbitrator

- Regulatory Notice 13-21, Effective July 1, 2013
- Exclusion of Persons Associated with Mutual Funds and Hedge Funds
- Implementation of the Two-Year Cooling-Off Period
- Arbitrators are encouraged to review amended definition of Rules 12100 (u) and 13100 (u) and Regulatory Notice 13-21 to determine eligibility.

Regulatory Notice 13-21, Effective July 1, 2013

- Amended the definition of public arbitrator to exclude persons associated with a mutual fund or hedge fund from serving as public arbitrators.
- Requires individuals to wait two years after ending certain affiliations before they may be permitted to serve as public arbitrators.
- Improves investors' perception about the fairness and neutrality of FINRA's public arbitrator roster
- Applies to all cases in which FINRA has not sent to the parties lists of chair-qualified public arbitrators and public arbitrators for arbitrator selection.

Exclusion of Persons Associated with Mutual Funds and Hedge Funds

- Code of Arbitration Procedure for Customer Disputes
  - 12100(u) Public Arbitrator - The term "public arbitrator" means a person who is otherwise qualified to serve as an arbitrator and:
    - (3) is not an investment adviser, or associated with, including registered through, a mutual fund or hedge fund.
- Code of Arbitration Procedure for Industry Disputes
  - 13100(u) Public Arbitrator - The term "public arbitrator" means a person who is otherwise qualified to serve as an arbitrator and:
    - (3) is not an investment adviser, or associated with, including registered through, a mutual fund or hedge fund.

Implementation of the Two-Year Cooling-Off Period

- Code of Arbitration Procedure for Customer Disputes
  - 12100(u) Public Arbitrator – The term "public arbitrator" means a person who is otherwise qualified to serve as an arbitrator and:
    - A person whom FINRA would not designate as a public arbitrator because of an affiliation under subparagraphs (3)-(7) shall not be designated as a public arbitrator for two calendar years after ending the affiliation.
- Code of Arbitration Procedure for Industry Disputes
  - 13100(u) Public Arbitrator – The term "public arbitrator" means a person who is otherwise qualified to serve as an arbitrator and:
    - A person whom FINRA would not designate as a public arbitrator because of an affiliation under subparagraphs (3)-(7) shall not be designated as a public arbitrator for two calendar years after ending the affiliation.

Implications on Panel Dynamics and Deliberation from an Insider's Perspective

FINRA's Pilot Program for Telephonic Mediation

- Began January 15, 2013.
- Offers parties in simplified cases pro bono or reduced-fee telephone mediation.
- Participation is voluntary and open to cases involving claims of $50,000 or less.
- Offers greater convenience and flexibility, and is a low-cost alternative to dispute resolution.
- Mediators would serve on a pro bono basis involving claims of $25,000 or less in damages.
- Reduced-fee mediation ($50 per hour) would be available on cases with damage claims between $25,000.01 and $50,000.
- FINRA will not charge any administrative fee for these cases.
- To participate in the program, sign and return the "Small Claims Mediation Submission Agreement" located on FINRA's website.

New Case Filings through July:

2011	2012	2013	2013 vs 2012
2,915	2,740	2,205	-20%

Summary Arbitration Statistics July 2013 – www.finra.org/ArbitrationAndMediation/FINRADisputeResolution

Turnaround Time[1] (in months) through July:

	2011	2012	2013	2013 vs 2012
Overall	14.3	14.7	14.4	-2%
Hearing Decisions	15.9	16.8	17.3	5%
Simplified Decisions	6.3	7.1	7.6	8%

[1]***The timing*** **of the arbitration process is heavily influenced by Code of Arbitration Procedures time limits, the parties, and the panel.**

Mediation Cases Closed through July:

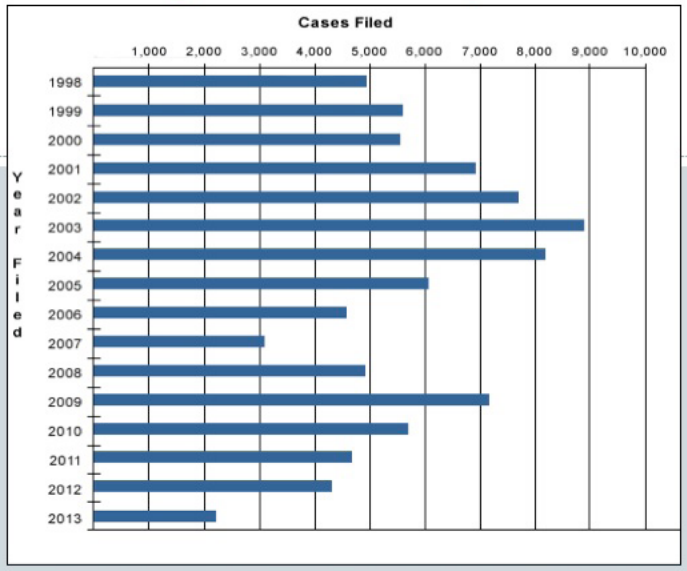
	2011	2012	2013	2013 vs 2012
Cases Closed	431	478	329	-32%
Percent Settled	80%	78%	80%	

Arbitration Cases Filed

Year	Cases
1998	4,938
1999	5,608
2000	5,558
2001	6,915
2002	7,704
2003	8,945
2004	8,201
2005	6,074

Year	Cases
2006	4,614
2007	3,238
2008	4,982
2009	7,137
2010	5,680
2011	4,729
2012	4,299
Through July 2013	2,205

Yearly Volume Comparison



Arbitration Cases Served by Controversy Involved

Type of Controversy[1]	2009	2010	2011	2012	July 2013
Margin Calls	128	83	80	68	33
Churning	306	270	236	245	137
Unauthorized Trading	478	397	288	313	155
Failure to Supervise	2,691	2,372	2,007	1,657	872
Negligence	3,405	2,698	2,249	1,941	1,010
Omission of Facts	2,453	1,941	1,603	1,355	737
Breach of Contract	2,802	2,184	1,904	1,573	805
Breach of Fiduciary Duty	4,206	3,162	2,589	2,216	1,093
Unsuitability	2,473	1,974	1,619	1,354	746
Misrepresentation	3,408	2,601	2,102	1,769	903

[1] Each case can be coded to contain multiple controversy types. Therefore the columns in this table cannot be totaled to determine the number of cases served in a year.

Results of Customer Claimant Arbitration Award Cases

Year Decided	All Customer Claimant Cases Decided (Hearings & Paper)	Percentage Decided of All Customer Claimant Cases Closed	Percentage (and Number) of Cases Where Customer Awarded Damages[1]
2008	474	20%	42% (199 cases)
2009	669	21%	45% (304 cases)
2010	882	20%	47% (415 cases)
2011	670	16%	44% (297 cases)
2012[2]	570	18%	45% (255 cases)
2013	294	18%	39% (115 cases)

[1] Percentage of customer claimant award cases reflects only instances in which investors as claimants recovered monetary damages or non-monetary relief.

[2] In 2012, approximately 78 percent of customer claimant cases resulted, through settlements or awards, in monetary or non-monetary recovery for the investor.

Comparison of Results of All-Public Panels and Majority Public Panels in Customer Claimant Cases

Year Decided[1]	Cases Decided by All-Public Panels[2]	Percentage (and Number) of Cases Decided by 3 Public Arbitrators Where Customer Awarded Damages	Cases Decided by Majority-Public Panels[3]	Percentage (and Number) of Cases Decided by 2 Public Arbitrators and 1 Non-Public Arbitrator Where Customer Awarded Damages
2011	13	54% (7 cases)	17	18% (3 cases)
2012	99	49% (49 cases)	111	33% (37 cases)
2013	73	42% (31 cases)	68	41% (28 cases)

[1] An all-public option for arbitration panels was implemented on Feb 1, 2011. Statistics reflect cases heard with awards from that point forward.
[2] Three public arbitrators.
[3] Two public arbitrators and one non-public arbitrator.

Arbitrators by Type

Arbitrator Type	Total
Public	3,595
Non-Public	2,891
Total	6,486

About Anthony Soukenik

Partner | Sandberg Phoenix & von Gontard | St. Louis, MO

314.446.4279 | asoukenik@sandbergphoenix.com
http://www.sandbergphoenix.com/attorneys-anthony-soukenik/

Anthony J. Soukenik is a shareholder of Sandberg Phoenix & von Gontard and serves on the Executive Committee. Tony is a member of the Business Law Practice Group and focuses his practice in the areas of banking, corporate law, estate planning, real estate and federal and state taxation. Tony is now available to mediate civil disputes.

Prior to joining Sandberg Phoenix, Tony was a shareholder at McSweeney, Slater and Merz, P.C. Tony served as a Law Clerk to the Honorable James Reinhart and Honorable Kent Karohl, Missouri Court of Appeals.

Tony has been named to the Missouri & Kansas Super Lawyers in the Business and Corporate areas, and he was also named a Five Star Wealth Manager for St. Louis.

Tony is a member of the Community Associations Institute; Home Builders Association of Greater St. Louis; Member of the Board, Network of Sacred Heart Schools; Member and Former Chair, DePaul Health Center Foundation; Member and Co-Chair, City of Hazelwood Board of Appeals; Member of the Advisory Board, First National Bank of St. Louis; FINRA, Financial Industry Regulatory Authority Arbitrator; Former Vice President and Commissioner of the St. Louis Regional Convention and Sports Complex Authority; Former Member, Saint Louis University Gift and Bequest Council; Past President, Community Association Institute, St. Louis Chapter, 1988; Former Lecturer, Saint Louis University; Past Member, Old Jamestown Area Planning Study, St. Louis County Planning Department; Former Trustee of the Metropolitan Sewer District – 2001-2003; Past Member, Metropolitan Sewer District, Storm Water Advisory Committee; Past Member, Metropolitan Sewer District, Strategic Business Plan Advisory Committee.

Education

- LLM, Taxation, from Washington University in 1993.
- Juris Doctor, from Saint Louis University School of Law in 1986.
- B.S. in Accounting, cum laude, Jesuit Honors Program, from Saint Louis University in 1982.